

IT 96-53

Tax Type: INCOME TAX

Issue: Penalty Under 1002(d) - Failure To File/Pay Withholding

STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE HEARINGS DIVISION  
CHICAGO, ILLINOIS

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THE DEPARTMENT OF REVENUE	)	
OF THE STATE OF ILLINOIS,	)	No.
	)	
Petitioner	)	
	)	
v.	)	SSN:
	)	
TAXPAYER,	)	
as responsible officer	)	Linda K. Clifffel,
of CORPORATION	)	Admin. Law Judge
	)	

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RECOMMENDATION FOR DISPOSITION

**APPEARANCES:** Martin Weinstein of Sugar, Friedberg & Felsenthal for TAXPAYER; Thomas Jacobsen, Special Assistant Attorney General, for the Illinois Department of Revenue.

**SYNOPSIS:**

This matter comes on for hearing pursuant to the protest of the Notice of Deficiency ("NOD") Number for TAXPAYER issued by the Department against him on April 7, 1994 as a responsible party of CORPORATION (hereinafter referred to as "CORPORATION"). The NOD represents officer's liability for Withholding Tax admitted by CORPORATION as due to the Department for the fourth quarter 1990 but which is unpaid.

A hearing in this matter was held on February 7, 1995. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the taxpayer.

**FINDINGS OF FACT:**

1. CORPORATION was formed to develop and produce a notebook-sized computer. (Tr. pp. 16-17, 417)
2. XXXXX provided the start-up capital for the company. (Tr. pp. 15, 17-24, 165-166)
3. TAXPAYER was the President of CORPORATION and was in charge of the operation of the company. (Tr. pp. 124, 129-130)
4. VP was a Vice President of the company and provided the engineering expertise for designing the computer. (Tr. p. 129)
5. VICE PRESIDENT was a Vice President of CORPORATION and was in charge of marketing and advertising. (Tr. p. 129)
6. The Directors of the corporation were XXXXX, OFFICER, TAXPAYER, VICE PRESIDENT, VP and ACCOUNTANT, the outside accountant for the company. (Tr. pp. 124 and 131) XXXXX was Chairman of the Board of CORPORATION. (Tr. p. 123)
7. ACCOUNTANT was the Treasurer of the corporation. (Tr. p. 131)
8. XXXXX was given a list of expenditures, which was prepared by TAXPAYER, every week or two. (Tr. p. 153) XXXXX would approve the expenditures and issue a check in the aggregate for the amount he had approved. (Tr. p. 165)
9. XXXXX hired TAXPAYER and determined his level of compensation (Tr. pp. 36-37, 79, 150, 152)
10. The signature authority for the corporate bank account was held by XXXXX, OFFICER, TAXPAYER, VICE PRESIDENT, and VP. (Tr. p. 160)
11. Two signatures were required on corporate checks. Typically, TAXPAYER signed the checks and submitted them to OFFICER for countersignature. (Tr. pp. 164-165, 167)
12. In December 1990, TAXPAYER had a discussion regarding payroll taxes with ACCOUNTANT (Tr. p. 171, Dept. Ex. No. 21)
13. Payroll taxes were never on the list of expenditures prepared by TAXPAYER. (Tr. pp. 173-174)
14. A subsequent meeting was held in January of 1991 to discuss the payroll tax situation. XXXXX agreed to fund the money needed to pay the payroll taxes on

the condition that CORPORATION gave him a promissory note in that amount and TAXPAYER, VP, and VICE PRESIDENT each give up a 5% equity holding in the company. (Tr. pp. 177-178, Dept. Ex. No. 20))

15. On January 31, 1991, the agreement between XXXXX, the TAXPAXYER AND VICE PRESIDENT, and VP was executed, and TAXPAYER was fired. (Tr. p. 196, Dept. Ex. No. 23)

#### **CONCLUSIONS OF LAW:**

The penalty at issue herein is based upon the withholding tax liability of CORPORATION for the fourth quarter of 1990. The corporation submitted to the Department the required tax return without payment for the amount stated therein. The Department seeks to impose personal liability on TAXPAYER pursuant to Ill. Rev. Stat. 1991, ch. 120, ¶1002(d),<sup>1</sup> which provides:

Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over...For purposes of this subsection, the term "person" includes an individual, corporation or partnership, or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs.

CORPORATION<sup>2</sup> was created to design and manufacture a notebook-size computer. TAXPAYER ("TAXPAYER") was the President and a Director of CORPORATION. As president, he was in charge of operations. The other principals in the corporation were VP, who provided the idea and the technical knowledge, VICE PRESIDENT, who was in charge of marketing, and XXXXX, who provided the funding.

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<sup>1</sup> The liability for payroll taxes herein accrued in 1991. Therefore, the statute which applies is Ill. Rev. Stat. 1991, ch. 120, ¶1002(d). The Uniform Penalty and Interest Act, 35 ILCS 735/3-7, which provides for a personal liability penalty, is effective for taxes incurred January 1, 1994 and later.

<sup>2</sup> Originally formed as COMPUTER.

There are two elements which are required by the statute in order for personal liability to be imposed for the failure to pay withholding taxes. First, the person must be a responsible party and second, the failure to pay must be willful. By introducing the NOD into evidence, the Department has proved its *prima facie* case against TAXPAYER. The burden of proof then passes to TAXPAYER to rebut the Department's *prima facie* case.

TAXPAYER was responsible for preparing a list of outstanding bills and presenting them to XXXXX to be approved for payment. After reviewing the list, XXXXX would give the company a check for the total amount to be paid out. TAXPAYER would then cut the checks, sign them and give them to OFFICER, the corporate Secretary for countersignature.

Internal Revenue Code Section 6672 is similar to the Illinois statute in that it holds corporate officers responsible for the willful failure to pay federal withholding taxes. Cases interpreting Section 6672 hold that a responsible person is one with significant control over the corporation's disbursement of funds. See, Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970); Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979) (responsibility is a matter of status, duty and authority, not necessarily knowledge). TAXPAYER was clearly in such a position.

As to the second prong of the test, however, the failure to pay must be willful. TAXPAYER testified that payroll taxes were never included as a disbursement on his list to XXXXX and that it was his belief that nothing was required of him in that regard. TAXPAYER said that he was told by ACCOUNTANT, the accountant for CORPORATION, that there was no tax liability to the officers of CORPORATION for their salaries since CORPORATION was a sub-chapter S corporation and the losses incurred by the corporation would offset their income. (Tr. pp. 146-147) Since TAXPAYER was not schooled in the technical aspects of the Internal Revenue Code and subchapter S corporations, it was not unreasonable for him to accept the accountant's explanation.

The issue of unpaid payroll taxes was first raised in December of 1990 at a meeting between TAXPAYER and ACCOUNTANT. A later meeting was then held between XXXXX, VP and TAXPAYER and VICE PRESIDENT. At that meeting XXXXX advised the TAXPAXYER AND VICE PRESIDENT and VP that he would pay the payroll tax liability in exchange for a percentage of their shares in the company and CORPORATION' promissory note for the amount of the loan. An agreement was signed by the parties (Dept. Ex. No. 23) to that effect. Shortly after the agreement was signed, TAXPAYER was fired.

Once TAXPAYER was apprised of the outstanding payroll tax liability, he took the necessary steps to see that funds were raised to pay it. He acquiesced to XXXXX demands, signed the agreement and then expected that those funds would be disbursed as they always had been. Since TAXPAYER was fired immediately afterward he was no longer in a position to direct the disbursement of funds or see whether or not such disbursement was made.

Although the Illinois Supreme Court in Branson v. Department of Revenue, 168 Ill.2d 247 (1995), held that the introduction of the Notice of Penalty Liability was sufficient to establish a *prima facie* case of willful failure to pay retailers' occupation taxes, I find that TAXPAYER has submitted sufficient evidence to rebut the Department's *prima facie* case as regards willfulness.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Deficiency against TAXPAYER be disallowed.

Date:

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Linda K. Cliffl  
Administrative Law Judge